99 Problems:

Tax Planning in a Time of Uncertainty

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Agenda

Easier Said Than Done: Repatriation Under Section 245A

The Perfect Storm or Two Ships Passing in the Night: The Impact of International Tax Reform on Intangible Planning

What to Expect When You're Expecting: Review of Forthcoming Regulations

Easier Said Than Done:

Repatriation Planning After
Section 245A

Easier Said Than Done:

Repatriation Planning After Section 245A

Dividend Paid by

Specified 10 percent owned foreign corporation (and not a PFIC)

Dividend Received by

Domestic corporation that is a “United States shareholder”

Deduction

Equal to the “foreign source portion” of the dividend

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Repatriation Planning After Section 245A

$$\boxed{\text{Foreign Source Portion}} = \boxed{\text{Dividend}} \times \frac{\boxed{\text{Undistributed Foreign Earnings}}}{\boxed{\text{Total Undistributed Earnings}}}$$

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Repatriation Planning After Section 245A

Dividends

- Intended to be interpreted broadly
- Also applies to dividends received by a CFC
- Does not include distributions of PTI

Foreign Earnings

- All earnings except for:
  - Earnings attributable to effectively connected income; and
  - Earnings attributable to distributions from 80-percent owned domestic corporations

Total Earnings

- As of year end in accordance with principles of section 964(a) and 986
- Determined without regard to dividends paid during the year

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– Special Rules for "Hybrid Dividends"

- Generally, any dividend where the CFC payor receives a deduction or "other tax benefit" with respect to the payment of the dividend.
- In the case of a hybrid dividend:

United States shareholder is not eligible for the section 245A deduction; and

If paid to another CFC in a tier, the distribution is treated as subpart F income to the United States shareholder

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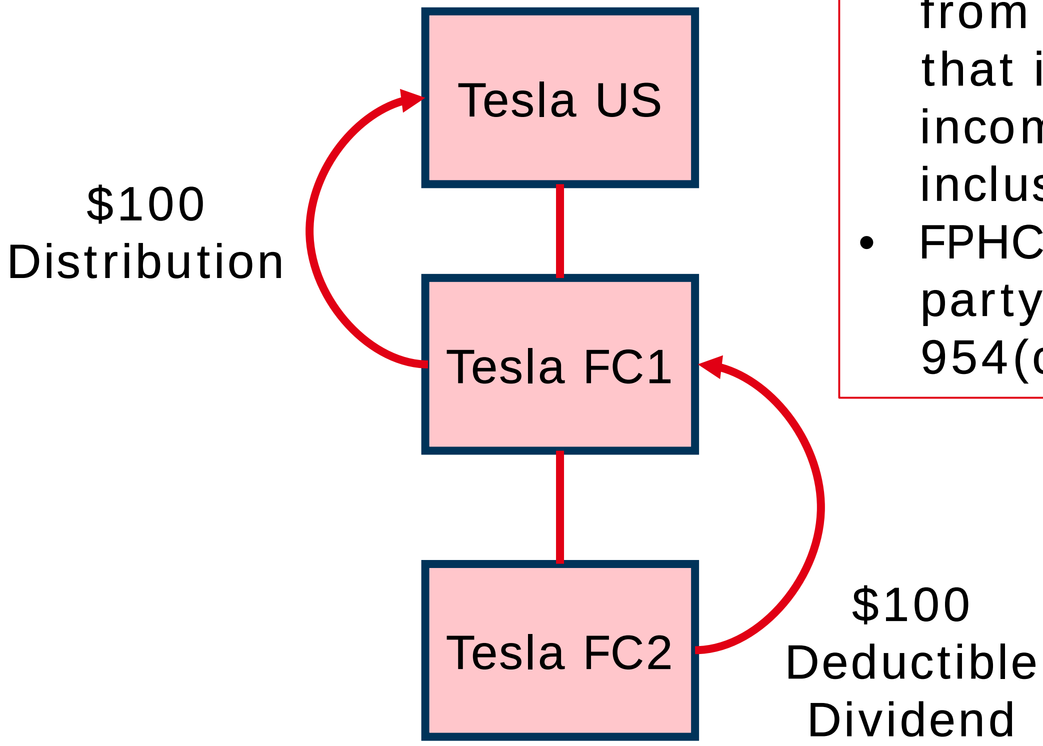
Repatriation Planning After Section 245A

— Special Rules for Hybrid Dividends



- The $100 deductible dividend from FC2 is a "hybrid dividend" that is treated as subpart F income at FC1, resulting in an inclusion at Tesla US
- FPHCI exception for related party dividends in section 954(c)(6) does not apply

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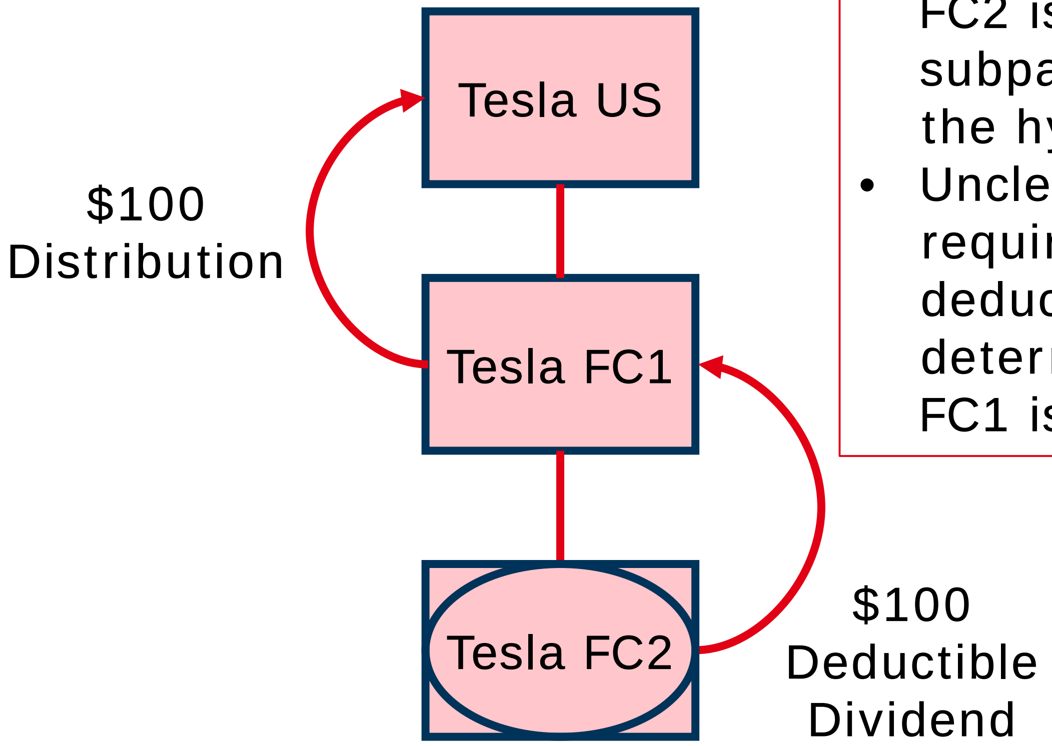
– Special Rules for Hybrid Dividends



- Because the distribution from FC2 is disregarded, there is no subpart F income at FC1 under the hybrid dividend rule
- Unclear if the taxpayer is required to look through to the deduction in FC2 when determining if distribution by FC1 is a “hybrid dividend”

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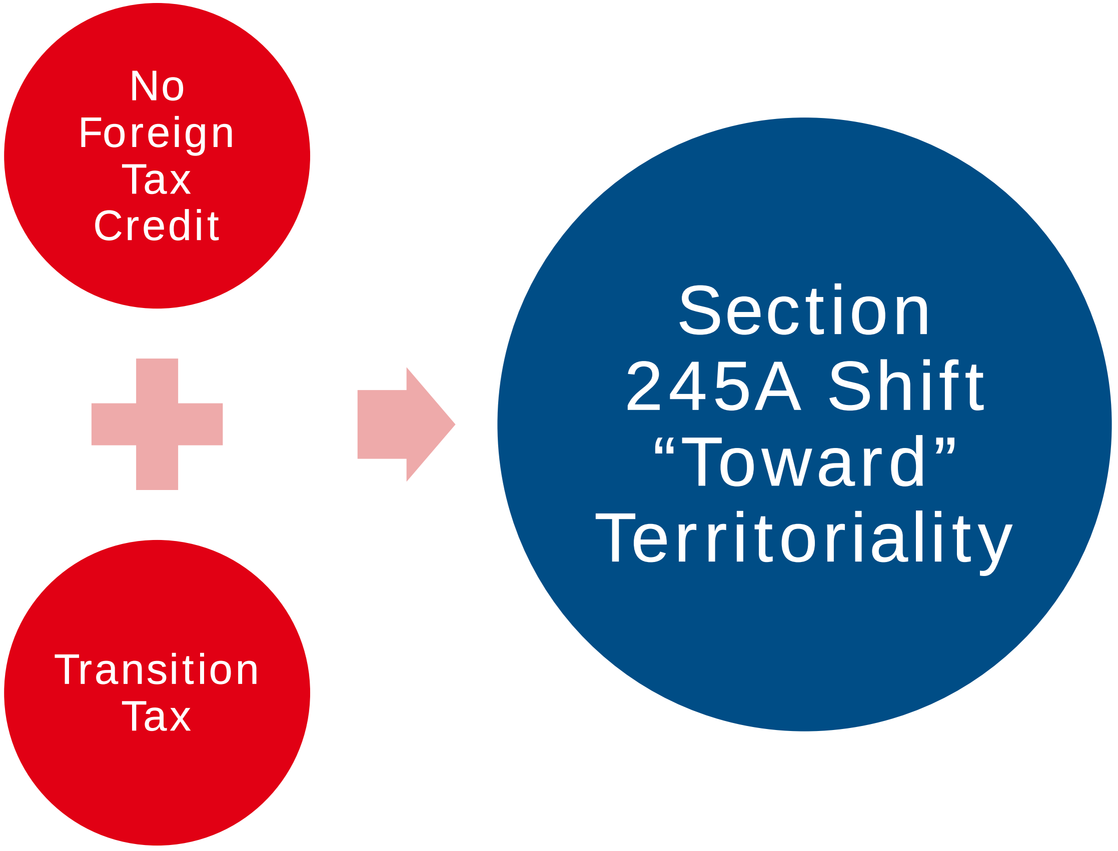
Repatriation Planning Under Section 245A

– But, there are tradeoffs:



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Repatriation Planning After Section 245A

- No section 901 **foreign tax credits** for taxes paid with respect to dividends that are eligible for the section 245A deduction
- Foreign tax credits also denied for hybrid dividends even though they are not eligible for 245A deduction
- Also applies to deny deduction for foreign taxes that would be creditable under section 901 if the taxpayer elected

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Repatriation Planning After Section 245A

– Significantly changes the landscape of **foreign tax credits**, but they continue to be relevant in other contexts, including:

- Subpart F Income (except hybrid dividends)
- Section 951A GILTI Inclusions
- Royalties, Interest, Other Withholdable Payments, including PTI Distributions
- Foreign Branch Income

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Repatriation Planning After Section 245A

- The dividend exemption also impacts the treatment of expense allocation for purposes of the **foreign tax credit** rules
  - Interest expense is now allocated and apportioned based on tax basis only—adjustments are made for undistributed earnings and profits
  - Treatment of shares in foreign corporations that produce exempt dividends is uncertain
  - Anticipated to be addressed in proposed foreign tax credit regulations that are forthcoming

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Repatriation Planning After Section 245A

– Section 965 Transition Tax

- In order to make the shift from worldwide to territorial, section 965 effectively requires the current inclusion of a United States shareholder's pro rata share of the net accumulated earnings and profits of its "specified foreign corporations"

* The determination is made as of one of two measurement dates in 2017
* Taxed at a reduced rate, based on the cash position of the specified foreign corporations
* Proposed regulations address the calculation of the amount of inclusion and payment

- For calendar year taxpayers with calendar year CFCs, the section 965 inclusion is on the 2017 tax return, which was due October 15, 2018

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Repatriation Planning After Section 245A

– The Continuing Relevance of the Section 965 Inclusion Amount:

Previously Taxed Income

- Amounts taken into account under section 965 are section 959 PTI
- Generally can be distributed without additional US tax

Basis

- Basis in shares is increased by positive earnings inclusions
- Proposed regulations provide election to shift basis from deficit subsidiaries to facilitate repatriation

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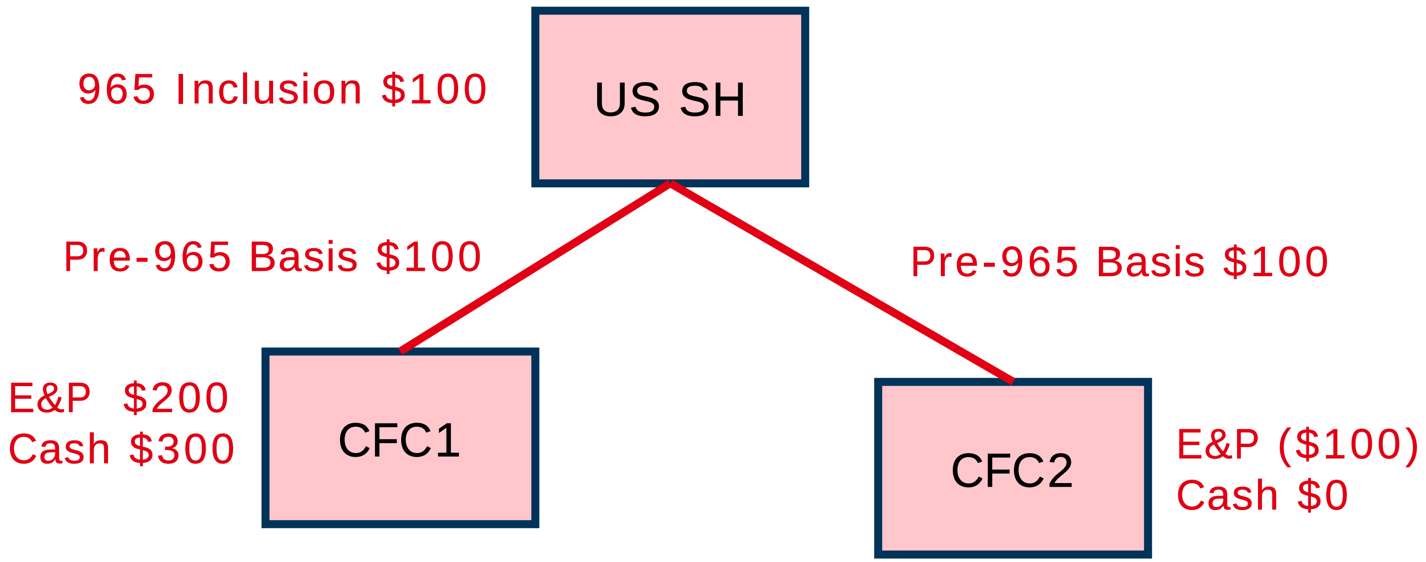
Repatriation Planning After Section 245A

– The Significance of the Basis Election
  - Under the statute, a United States shareholder's basis in its CFC is increased by the amount of positive earnings and profits included under section 965
  - Section 965 is net accumulated earnings, so deficits in one CFC can offset positive earnings in another CFC



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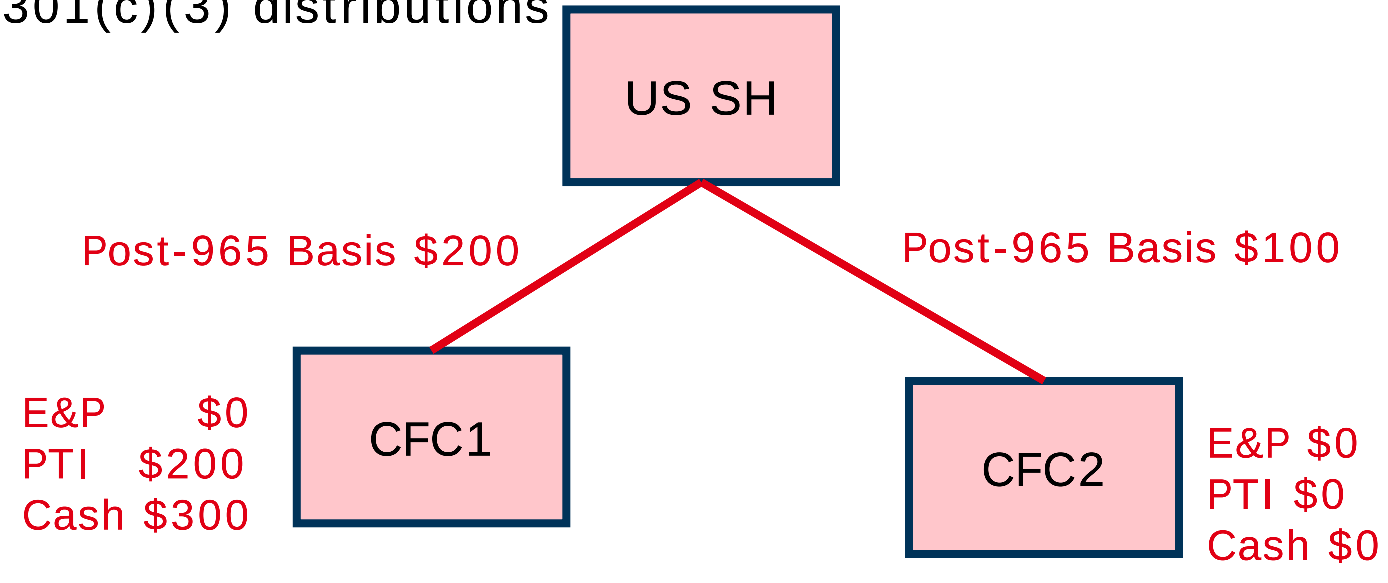
Repatriation Planning After Section 245A

– The Significance of the Basis Election

- In the example, United States shareholder's basis in CFC1 is increased under section 961 by $100, the amount of the earnings included
- If CFC1 were to try to distribute the $300, however, $100 would be a non-dividend distribution that would give rise to taxable gain; Section 245A applies only to dividends, not to section 301(c)(3) distributions



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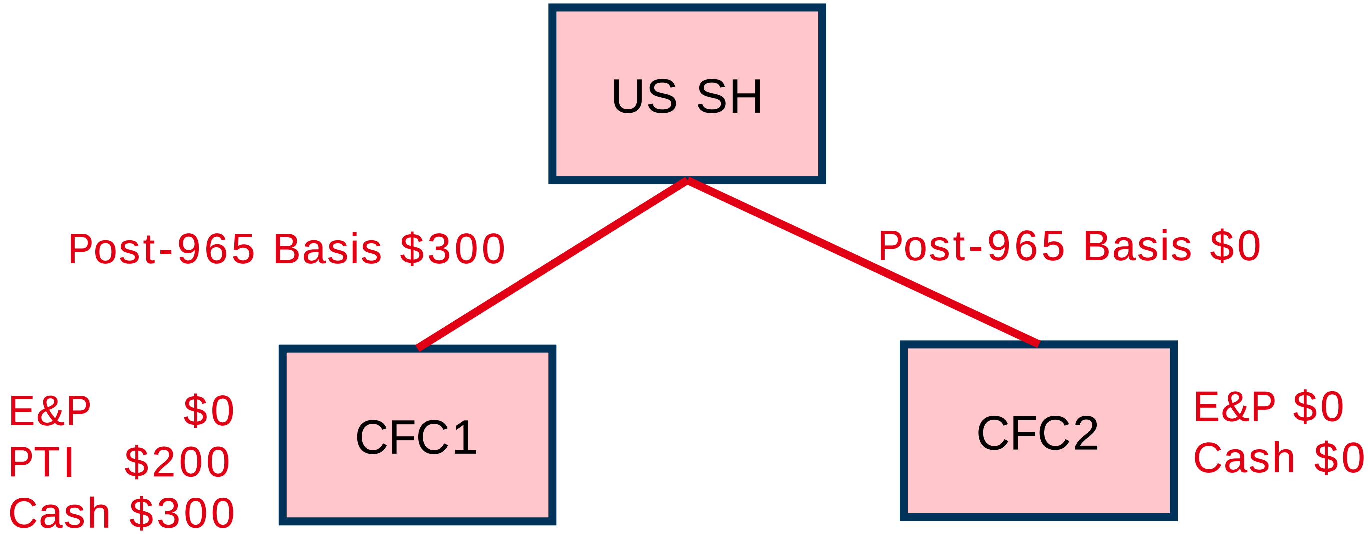
Repatriation Planning After Section 245A

– The Significance of the Basis Election

- If US SH makes the basis election, then the $100 of basis in CFC2 is allocated to its interest in CFC1 and CFC1 can distribute its $300 of cash without triggering additional US tax
- Basis in CFC2 is eliminated, which may impact future distributions absent earnings in CFC2



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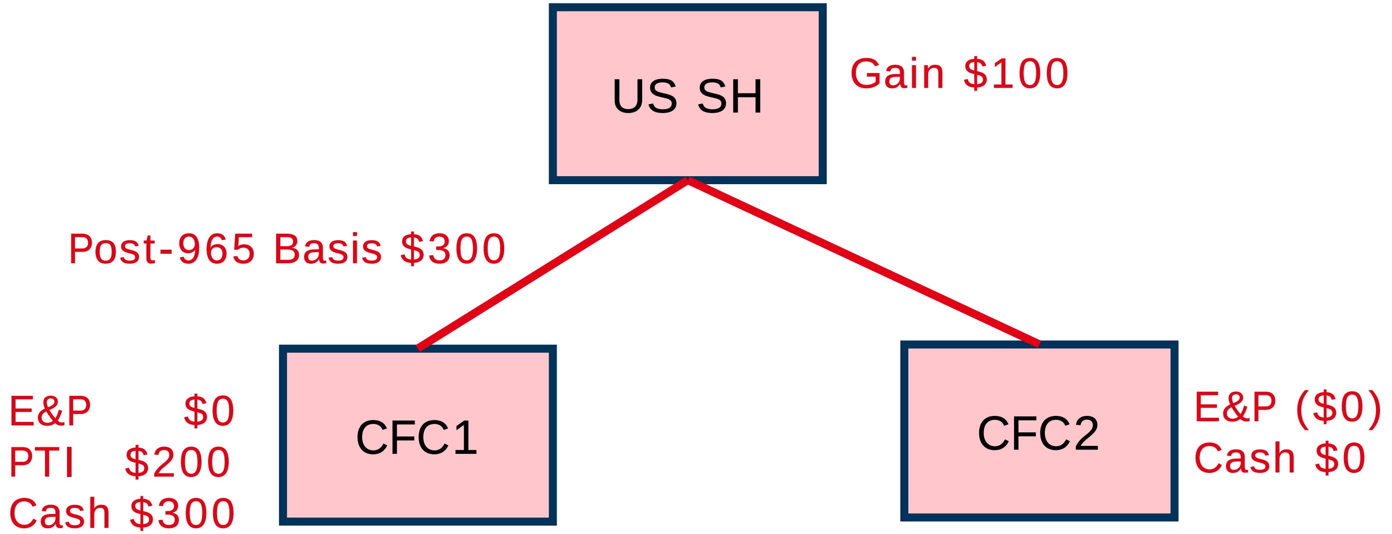
Repatriation Planning After Section 245A

– The Significance of the Basis Election

- If CFC2 had no basis and the election were made, the amount of CFC1's basis still can be increased by the amount of the deficit allocated from CFC2, but reduction in CFC2's basis would give rise to taxable gain in the year of the 965 inclusion, which is 2017 for calendar year taxpayers



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Repatriation Planning After Section 245A

– Operational considerations for the basis election

Filing	• One-time election that is made for all SFCs on return that includes first section 965 inclusion
Uncertainty	• Regulations are proposed and changes to calculation could impact decision whether to make election
Timing	• Notice 2018-78 provides that taxpayers will have 30 days from final regs to make or change an election

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Repatriation Planning After Section 245A

– Ordering rules for distributions from foreign corporations

E&P
- *Does the foreign corporation have earnings and profits as determined under US tax principles*
- *If not, distribution may be return of basis or taxable gain*

Subpart F
- *Determine the amount of any subpart F inclusions with respect to the foreign corporation*
- *If no earnings and profits, E&P limitation may apply*

GILTI
- *Determine the amount of any GILTI inclusions with respect to the foreign corporation*

PTI
- *Under section 959, previously taxed income is not subject to tax again upon receipt by the United States shareholder*
- *Subpart F income, GILTI inclusions, as well as section 965 inclusions are PTI*

DRD
- *Assuming distribution is not PTI and other requirements are satisfied (e.g., holidng period and not a hybrid dividend), what is the foreign source portion (i.e., not ECI or from an 80 percent owned US sub)*

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Repatriation Planning After Section 245A

- What about deemed distributions under section 956?

Section 956 generally treats investments made by a CFC in "United States property" as distributions to the United States shareholders of the CFC

Purpose of the section 956 rule was to ensure symmetry between actual distributions and deemed distributions

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Repatriation Planning After Section 245A

– Proposed Regulations under section 956

- Generally reduces the section 956 inclusion of a corporate United States shareholder in a CFC by an amount equal to the section 245A DRD available on a hypothetical actual distribution.
- Section 956 continues to apply to non corporate taxpayers that are not eligible for 245A (e.g., individuals, RICs and REITs)
- Removes potential traps for the unwary, but reduces electivity that potentially could have been favorable to some taxpayers.

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Repatriation Planning After Section 245A

– Change in Current Law
  - The preamble states that absent the Proposed Regulations, section 245A would not apply to a section 956 inclusion, which is consistent with case law interpreting whether a section 956 inclusion is eligible for the preferential tax rate for “qualified dividend income” under section 1(h)(11)

– Effective Date
  - Proposed to be effective for tax years of a CFC beginning on or after the date the regulations are published as final and for tax years of United States Shareholders within which such CFC years end.
  - Taxpayers may rely on the regulations for tax years of a CFC beginning after December 31, 2017, as long as the taxpayer and all related persons do so consistently

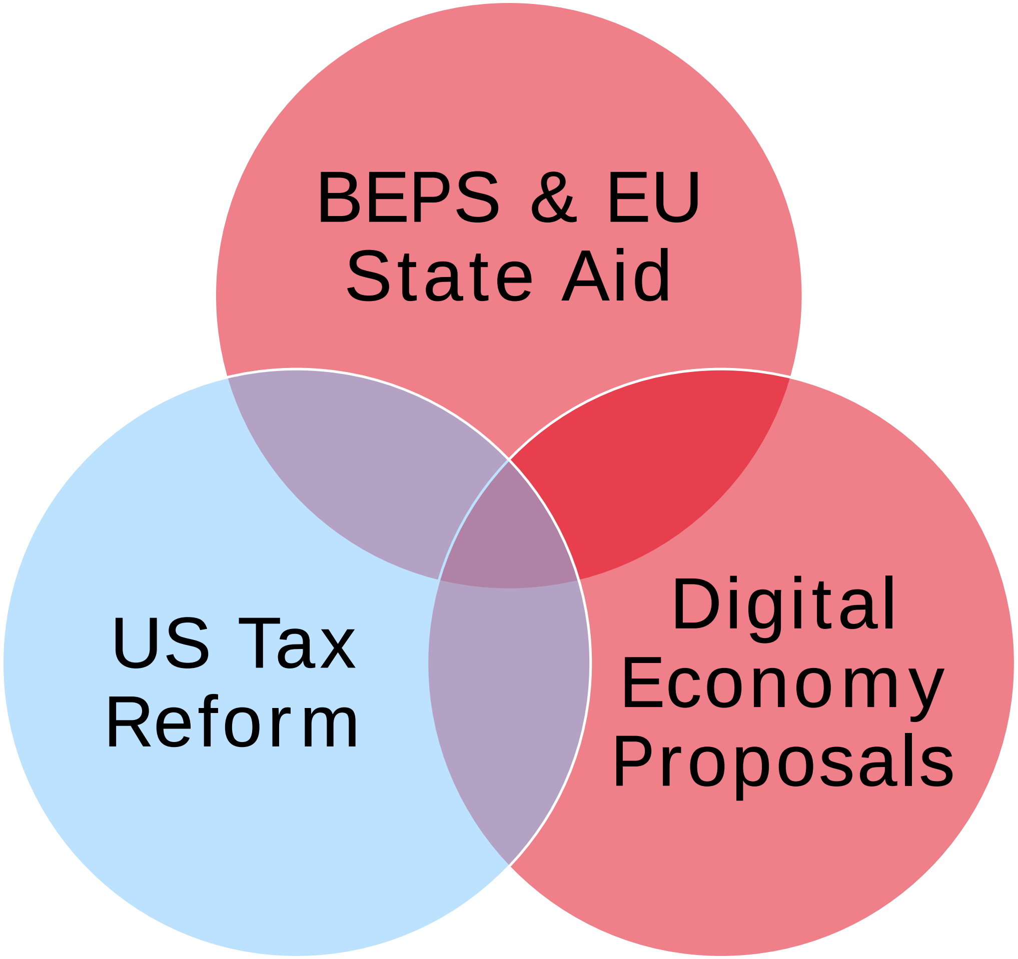
The Perfect Storm or Ships Passing in the Night:

International Tax Reform and Intangibles Planning

The Perfect Storm or Two Ships Passing In the Night

International Tax Reform and Intangibles Planning

- The intersecting landscape of international tax



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International Tax Reform and Intangibles Planning

– Whether explicit or implicit, the approach to taxing intangible income differs

US Tax Reform	EU Tax Reform
Effective worldwide minimum tax through GILTI/FDII	Transfer pricing and state aid challenges
Transfer pricing and taxing outbound transfers	Tax proposals targeting the digital economy

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International Tax Reform and Intangibles Planning

– Principal factors influencing decisions with respect to the location and ownership of intangibles include:
  - Reduced U.S. corporate tax rate of 21% (and potential reduced rate for FDII)
  - Section 951A GILTI rules with U.S. corporate tax rate comparable to FDII offset with foreign tax credits, which effectively imposes global minimum tax on earnings of foreign corporations
  - Tightening of international transfer pricing rules
  - EU state aid challenges and elimination of beneficial tax regimes throughout the EU
  - Amendments to permanent establishment standards, including under the MLI
  - Proposals targeting income from digital services
  - Others?

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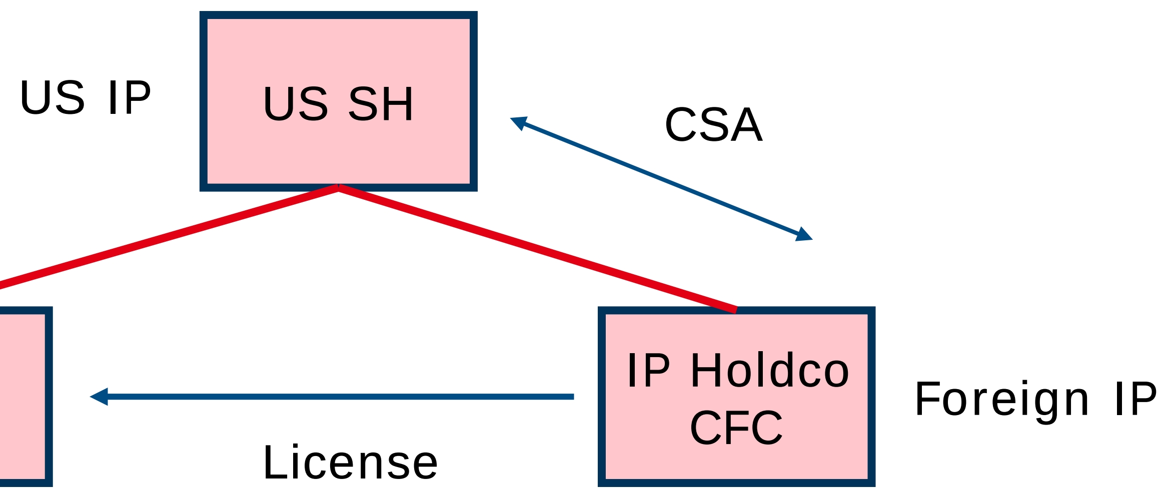
International Tax Reform and Intangibles Planning

– Does repatriation of offshore IP address international reform considerations for U.S. multinationals?

Basic Structure



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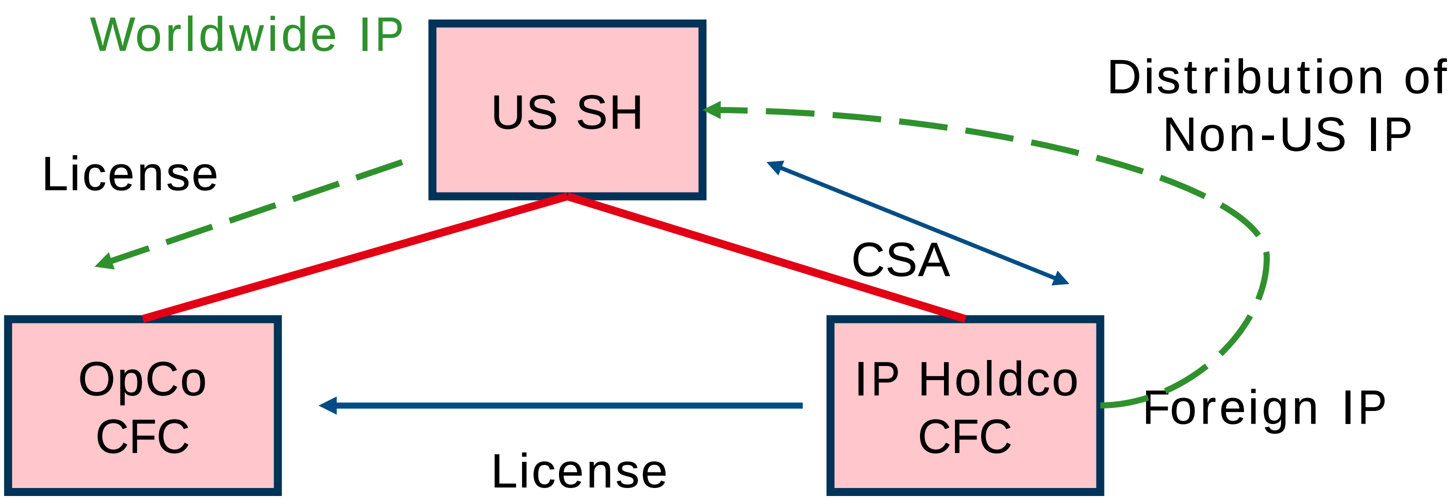
International Tax Reform and Intangibles Planning

- What if IP Holdco distributes the Non-US IP to US SH and then US SH licenses worldwide IP.
- Potentially CTB on IP Holdco CFC if willing to inbound everything

IP Distribution



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International Tax Reform and Intangibles Planning

– But, extraction is not tax free

US Tax Cost		
Distribution may give rise to subpart F income	Potential for GILTI inclusions for gain on distribution	Value in excess of relevant attributes may be taxable to the shareholder

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International Tax Reform and Intangibles Planning

– But, extraction is not tax free

Non-US Tax Cost

Non-Recoverable Exit Taxes	Withholding on Royalties	Permanent Establishment Risk

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International Tax Reform and Intangibles Planning

– Benefits of consolidating IP in the US:

- Reduced 21 percent corporate tax rate
- Royalty income potentially qualifies for section 250 FDII deduction
- May address transfer pricing and substance concerns
- Address uncertainty surrounding beneficial tax regimes

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International Tax Reform and Intangibles Planning

– Sounds great, so why not?

- Potential increase in US tax rate and inability to transfer back efficiently
- WTO challenges and sunset for full FDII benefits
- Transfer pricing and permanent establishment considerations related to existing non-US operations
- Tax cost of extracting assets

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International Tax Reform and Intangibles Planning

- So what does this mean for current planning?
  - Uncertainty weighs against current changes to take advantage of tax reform
  - For new transactions and acquisitions, important to consider alternatives
- Planning may not accomplish intended objectives unless it aligns with business realities
  - Moving existing problems may not eliminate them (e.g., transfer pricing, cost sharing, intangible creation)

What to Expect When You're Expecting:
Review of Forthcoming Regulations

What to Expect When You're Expecting:

Review of Forthcoming Regulations

Proposed Regulations – Issued	Proposed Regulations – TBD
Section 965 – Transition Tax	Section 163(j) – Interest Limitation
Section 951A – GILTI	Section 59A – BEAT
Section 956 – addressing section 245A	Foreign Tax Credit
	[Section 250 – FDII]

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